Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the matter of

Fees for Ancillary or Supplementary
Use of Digital Television Spectrum
Pursuant to Section 336(e)(1)
of the Telecommunications Act of 1996

MM Docket No. 97-247

REPLY COMMENTS OF THE ASSOCIATION OF LOCAL TELEVISION STATIONS, INC.

The following reply comments are submitted by the Association of Local Television Stations, Inc. ("ALTV"), in response to the Commission's *Notice of Proposed Rule Making* in the above-captioned proceeding.[1] Only a few matters require a considered response. By and large, the commenting parties stand in general agreement about the major issues. Only two of the comments filed contribute arguments or evidence which might tend to lead the Commission astray if left unrebutted. Those comments are the primary focus of these reply comments.

NCTA urges that any fee represent a significant proportion of a station's gross revenue from ancillary and supplementary services and challenges the Commission's notion that a gross revenue fee be set at a lower percentage than a net revenue fee.[2] This position is rooted in NCTA's demonstrably absurd proposition that "almost all of the revenue generated by ancillary and supplementary services would correctly be viewed as 'profit' in both the economic and accounting

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[1]FCC 97-414 (released December 19, 1997)[hereinafter cited as *Notice*].

[2]Comments of the National Cable Television Association, MM Docket No. 97-247 (filed May 4, 1998) at 10-11 [hereinafter cited as "NCTA"]. A cross-reference index is attached hereto.

sense."[3] This contention essentially is based on the claim that the largest cost of providing ancillary and supplementary services will be the cost of spectrum (borne by the public, not the station) because the other costs of providing ancillary and supplementary services will be minimal.

This line of argument is fundamentally flawed. In an economic sense, it wrongly assumes a tight, precise relationship between gross revenues and spectrum scarcity rents. The relationship between revenue and spectrum scarcity value hardly is so precise.[4] As much as such a relation is undeniable, it still requires a very considerable leap of faith to embrace gross revenues as a basis for determining fees.[5] High revenues may or may not reflect the scarcity value of the spectrum used to provide the service.[6] Thus, to view "almost all revenue" as profit, a significant portion of

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[3]NCTA at 11.

[4]*See Notice* at ¶20; Haring, John, *Fees for Ancillary and Supplementary Use of Digital Television Spectrum*, Strategic Policy Research (April 28, 1998), at 10 [hereinafter cited as "Haring"], a copy of which is attached to Comments of The Association of Local Television Stations, Inc., MM Docket No. 97-247 (filed May 4, 1998)[hereinafter cited as "ALTV"] .

[5]*See* Comments of the Information Technology Industry Council, MM Docket No. 97-247 (filed May 1, 1998) at 8[hereinafter cited as "ITIC"]("The Commission apparently believes that a methodology based on revenues received from feeable services would satisfy the statutory directive of a value-based methodology. In a very imprecise way, this may be true.")

[6]Haring at 2 ("... [T]here is a danger that rewards properly attributable to other scarce factors of production, including entrepreneurial effort and intellectual creativity, may be improperly attributed as spectrum scarcity rents. The fact that licensees successfully exploit opportunities to supply feeable services does not automatically translate into spectrum scarcity rents."); *see also id.* at 13-14.("While relevant scarcity rents may tend to be proportional to revenues or profits from sales of such services, they are not necessarily so and are certainly not synonymous with these measures. Consider that a firm may be able to transform sand into highly valued computing capabilities by combining it with other factors of production, notably human intellect, but that this does not convey a high scarcity value on sand. That sand can be supplied at low cost and that there are substitutes for sand make the scarcity value of sand minimal, notwithstanding the valuable uses to which sand may be put. DTV licensees may eventually be able to utilize their operating rights to supply valued feeable services and may even earn economic profits in so doing. These possibilities do not automatically translate into spectrum scarcity rents anymore than that billions of

which ought be funneled to taxpayers as reimbursement, is economically wrongheaded.[7] It ignores the distinction between monopoly profits and entrepreneurial profits. The former may provide a valid basis for determining fees. The latter do not.[8]

Second, in an accounting sense, NCTA's argument fares no better. In determining profits, it looks only to the incremental or marginal costs of providing ancillary and supplementary services.[9] NCTA asserts these costs will be "negligible" because the most substantial costs will be sunk costs.[10] No basis exists for such a myopic view of costs or for assigning such a low estimate to those costs. The Commission itself views costs more broadly even in the context of an incremental profit-based fee.[11] Furthermore, NCTA ignores the opportunity cost inherent in diverting spectrum away from free television services to ancillary and supplementary services. Finally, of course, the focus on marginal costs itself ignores the portion of joint and common costs

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dollars' worth of computer sales imply that sand possesses a high scarcity value or that sand supply ought to be more highly remunerated.").

[7] NCTA also calls for fees which are "reasonably related to the value of the spectrum." NCTA at 10. At the same time, it acknowledges that spectrum value is "unaffected by its particular use." NCTA at 11. It appears no less true that spectrum value would be unaffected by the revenues derived from any particular use of that spectrum.

[8] The government, as the Fox Television Stations Inc. points out, ought avoid "appropriating a broadcaster's productivity and creativity under the guise of collecting spectrum fees." Comments of Fox Television Stations Inc., MM Docket No. 97-247 (filed May 4, 1998) at 7 [hereinafter cited as "Fox"].

[9] NCTA at 11.

[10] NCTA at 11.

[11] *Notice* at ¶22 ("The service-specific incremental cost would include the costs of all directly-attributable inputs of production, such as labor and equipment, and the economic depreciation and rate of return on any specific capital assets that are used exclusively in the production of a given feeable ancillary or supplementary service.")

appropriately assigned to ancillary and supplementary services.[12] NCTA may well wish for competitive reasons that broadcasters' providing ancillary and supplementary services be saddled with the high fees, but its plainly erroneous contention that almost all revenues from such services would be profits offers no rational path toward making its wish come true.

NCTA also relies on pointedly bogus comparisons between fees applicable to spectrum used for ancillary and supplementary services and other fees collected by the government. Using the side door, NCTA states in support of its call for a gross revenue-based fee that "the federal government has years of experience with assessing fees based on gross revenues."[13] Of course, NCTA hardly hesitates to mention that fees for "scarce natural resources" like gas and oil range as high as 16.7 percent.[14] Such a comparison ignores critical distinctions between depletable resources like oil and gas and spectrum. Once oil and gas are pumped out of the earth below, they are gone, depleted. The opportunity cost (*i.e.*, the opportunity to use that oil in the future) is realized. Spectrum, however, by its nature is not depletable. It will be there as fresh and ready-to-go tomorrow as it was a billion years ago. NCTA's comparison, therefore, adds nothing to a rational debate about the appropriate level of DTV fees.[15]

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[12]ALTV is surprised that NCTA would focus on marginal costs. More typically in its efforts to avoid competition, NCTA would seek to have a telephone company providing cable service assign a substantial proportion of common costs to the cable service. In light of the more elastic demand for cable service (than for telephone service) from a telephone company, such a cost allocation would tend to make the cable service appear less profitable. However, when broadcasters offer new ancillary services with very elastic demand, NCTA ignores common cost allocations -- except with respect to spectrum scarcity value, which it allocates fully to the ancillary services. *See, e.g,* Comments of NCTA, CS Docket No. 96-46 (filed April 1, 1996) at 21-22.

[13]NCTA at 9.

[14]NCTA at 9.

[15]UCC *et al.* take the same misstep in arguing that a 10 per cent fee would be less than the fees mining and oil companies pay for mineral leases on federal lands. Comments of UCC, *et al.*, MM Docket No. 97-247 (filed May 4, 1998) at 9 [hereinafter cited as "UCC"].

In like vein, NCTA bases its claim that the value of DTV spectrum is substantial on the alleged value of spectrum used for cellular telephone service.[16] Again, the comparison of cellular spectrum values with DTV spectrum values is specious. NCTA proffers a calculation of spectrum price per pop based on the sale prices of established, thriving cellular systems. It then assumes a like per pop value for DTV spectrum. This comparison neglects critical distinctions between the value of established cellular systems and yet unborn (and likely unconceived) ancillary and supplementary services to be offered by broadcast DTV stations. The sale prices of established cellular systems represent the value of ongoing businesses providing a proven, popular service with extensive facilities (*e.g.*, countless towers dotting the landscape of the service area), large customer bases, vibrant marketing, billing, and administrative systems, and, most of all, large revenue streams producing large profits. In this context, scarcity rents largely have dissipated. Profits and value exist primarily in the fact that the cellular system is a going concern. In contrast, fledgling ancillary and supplementary services provided by DTV stations are likely to involve high-risk, unproven services via facilities still new and likely daunting to consumers. They will enjoy no assurance of even modest consumer acceptance or profitability. Indeed, profitability may follow a long unprofitable start-up period or elude the DTV licensee completely. NCTA's reliance on cellular system sale prices to estimate DTV spectrum values, therefore, is fanciful and roundly misplaced.[17]

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[16]NCTA at 12-13.

[17]Even assuming *arguendo* that cellular spectrum is comparable and that cellular providers paid a lot for it, one still may not conclude that cellular spectrum values are indicative of the value of DTV spectrum assigned to ancillary and supplementary services. *See* Haring at 5, n.6 ("The amount a competitor may have paid in an earlier auction does not necessarily correspond to the scarcity rents realized in the event. A competitor who has paid more for rights than they turn out to be worth may be disadvantaged, but this may be the result of his overpaying rather than a later competitor's underpaying."). Indeed, in light of a dramatically more competitive environment for cellular services with the deployment of PCS, the spectrum for which cellular providers paid high prices likely no longer is worth what they paid for it. This is confirmed by plummeting auction values for more recently auctioned spectrum. *See* ALTV at 9-11.

NCTA's concern that a net revenue fee would invite unjust enrichment of DTV stations also is unfounded. Certainly, such a fee would permit DTV licensees to attempt to develop ancillary and supplementary services to the breakeven point before paying fees. However, where no profits exist, no monopoly profit or scarcity rents may exist either.[18] On the other hand, broadcast licensees would be "unfairly burdened" *vis-a-vis* their competitors if fees exceed a reasonable estimate of the value of the spectrum used for ancillary and supplementary services.[19]

UCC *et al.* also call for fees which "generate significant revenue."[20] Indeed, UCC *et al.* call for fees as high as 10 percent of gross revenues. As much as they would prefer to see a "Robin Hood" fee which transfers commercial broadcasters' wealth to noncommercial broadcast entities, UCC *et al.* fail to grasp the self-defeating nature of their proposal. A fee set at a high rate will *not* generate significant revenue. Faced with such arguably confiscatory fee levels, DTV licensees are more likely to abandon their plans for ancillary and supplementary services. Consequently, no fees will be generated.[21] Furthermore, any expectations that DTV fees would generate significant

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[18]*See* Haring at 11. ("A seeming advantage of the first two approaches is that they tie fee payments to the actual realization of economic surplus/rent. Not all (or indeed any) rents may be attributable to spectrum scarcity, but if there are no rents, that precludes there being any spectrum scarcity rents."); *see also* Joint Comments of Cox Broadcasting, Inc., Paxson Communications Corporation, and Media General, Inc. On the Notice of Proposed Rulemaking, MM Docket No. 97-247 (filed May 4, 1998) at 8 [hereinafter cited as "Joint Comments"]. ("When confronted by operating losses, even non-payment of any fee does not constitute unjust enrichment. There can be no enrichment, just or unjust, from a non-profitable business.").

[19]Strategic Policy Research, *The Need for a Cap on Fees for Ancillary or Supplementary Use of Digital Television Spectrum* (May, 1998) at 5, attached to the Comments of Fox Television Stations Inc., MM Docket No. 97-247 (filed May 4, 1998).

[20]UCC at 3.

[21]*See* Joint Comments at 7.

revenues emanate from UCC *et al.*'s imagination.[22] Moreover, as noted by ALTV and others in their comments, excessively high fees going in pose a far greater threat to a sound result than fees which miss the mark (as elusive as it may be) on the low side.[23]ABC pointing to the high risk inherent in new services and the likelihood that fees would passed through to consumers, also warns that excessively high fees "could jeopardize the appeal and ultimate success of ancillary businesses."[24]

NCTA and UCC both cavalierly dismiss any reliance on the auction value of spectrum in setting DTV fees.[25] In doing so, they ignore the Commission's statutory mandate and place their common sense on hold.[26] Exactitude may be elusive, but general trends in spectrum values may be ignored only at risk of caprice.[27] Therefore, if the supply of spectrum generally has increased and

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[22]*See* ALTV at 11, n.23, *citing* Haring at 8, n.10.

[23]ALTV at 11-15; *see also* ITIC at 8 ("... [G]iven the overwhelming number and uncertainty of variables that must be considered in calculating a licenses' "value," any approach that attempts to estimate such value should be undertaken with extreme caution and should err on the side of low value, at least until demonstrable, reliable information exists to warrant adjusting the estimates.").

[24]Comments of ABC, Inc., MM Docket No. 97-247 (filed May 4, 1998) at 14.

[25]NCTA at 6-7; UCC at 4.

[26]47 U.S.C. §336(e)(2)(B)("[T]o the extent feasible, equals but does not exceed (over the term of the license) the amount that would have been recovered had such services been licensed pursuant to the provisions of section 309(j) of this Act and the Commissions's regulations thereunder....").

[27]Haring at 8 ("The fact that a Rembrandt drawing fetched a certain amount at auction may provide scant basis for predicting the auction value of a Cezanne oil — scant basis, but not no basis. Any valuation exercise of this type inevitably entails a process of guesstimation."). *See also* Comments of Fox Television Stations Inc., MM Docket No. 97-247 (filed May 4, 1998).

bids have declined to the point that auctions are being postponed for fear that no one will bid, then basic economic principles of supply and demand strongly indicate that the value of DTV spectrum devoted to ancillary and supplementary services likewise is small.[28]

UCC *et al.* seek arbitrary expansion of the scope of the fees to include home shopping, infomercial, and other direct marketing program revenues.[29] UCC *et al.* launch their argument by reciting part of the relevant statutory provision, while ignoring the pertinent proviso that no fees are to apply where the compensation received by a station from a third party constitutes "commercial advertisements used to support broadcasting for which a subscription fee is not required."[30] Home shopping, infomercial, and other direct marketing programming, however, fall squarely within this limitation. First, they are no more than common forms of commercial advertising.[31] Whereas they involve more ingenious methods of calculating the amount of consideration for the advertising, they no less than traditional spot advertising or program sponsorship involve the exchange of monetary consideration for time on a station to promote a product or service (*i.e.*, advertising time). Furthermore, they were well-known forms of advertising arrangements when Congress

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[28]*See* ALTV at 9-11; Haring at 14-15.

[29]UCC *et al.* also claim that broadcasters would be tempted to apply creative principles of accounting ("CPA") to escape or minimize fee payments if fees were based on net revenues. This suspicion is no more than an ungrounded and gratuitous slap at the integrity of broadcast licensees. UCC at 5-6.

[30]UCC at 13; 47 U.S.C. §336(e)(1)(B).

[31]That UCC *et al.* truly might consider these forms of programming something other than commercial advertising strikes ALTV as highly improbable.

enacted the statute.[32] No reason exists even to begin to suspect that Congress, nonetheless, sought to bring such forms of commercial advertising within the scope of the fees applicable to ancillary and supplementary services. Second, their revenues support broadcasting (and, indeed, the programs themselves are part of broadcasting) provided to the public as free, over-the-air television. No fee is charged viewers to such programs. Therefore, they readily fall outside the scope of feeable services as defined by the statute.[33]

UCC *et al.* embark on a similar flight of fancy in suggesting that revenues or other consideration from retransmission consent arrangements fall within the scope of the fees for ancillary and supplementary services. In the broadest sense, no ancillary or supplementary service is involved when a station enters into a retransmission consent agreement with a cable system or other multichannel video provider for retransmission of a free broadcast channel. Furthermore, neither of the statutory prerequisites is satisfied. No subscription fee is required to *receive* the service.[34] The station may well receive consideration from the cable system, but what cable system would pay a station for the right to *receive* its signal? Under retransmission consent agreements, the cable system by definition is paying for the right to *retransmit* the signal. Section 336(e)(1)(B) likewise is not implicated because the cable system is providing no consideration to the station in

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32 Per inquiry advertising, for example, has been around for decades -- just ask anyone who watched independent television in its infancy. No matter how one cuts it, chops it, or dices it, per inquiry advertising is still just that -- commercial advertising! Isn't it amazing!

33The fact that the promotional spot or program content is made available to consumers via a special icon on a free broadcast channel also is of no moment, contrary to the contentions of UCC *et al.* UCC at 13-14. DTV technology will provide the opportunity for multiple free channels. As long as no fee is charged to the viewer, revenues derived from advertising in whatever form on those channels remains outside the reach of the fees established in the statute.

3447 U.S.C. §336(e)(1)(A).

return for broadcast of any material furnished by the cable system.[35] Therefore, UCC *et al.*'s position is void of legal or rational support.

When all is said and done, the public will be best served by a fee regime which, while consistent with the statute, encourages innovation and investment in the development of ancillary and supplementary services provided in conjunction with free digital broadcasting.[36] Therefore, the Commission ought adopt a fee based on a modest percentage (one percent or less) of gross receipts with fee waivers for unprofitable services and a cap on fees so as to avoid recovering fees in excess of the spectrum scarcity values.[37]

Respectfully submitted,

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August 3, 1998

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[35] 47 U.S.C. §336(e)(1)(B).

[36] ITIC at 4 ("The convergence of the consumer electronics, computing, and telephony markets -- each of which is represented to some degree by ITI's membership -- is increasingly producing new voice, data, image, and video services which are transported over a variety of media, soon to include DTV. Consumers access these services with an astonishing array of new products sold at affordable prices. Driven down by vigorous competition.With the advent of DTV, this trend could be expected to accelerate rapidly unless regulation of the new medium, particularly the fee program, interferes with the development of DTV and the products and services it will spawn.").

[37] ALTV's proposal for fee waivers for unprofitable ventures (ALTV at 19-20) draws support from Cox *et al.* (Joint Comments at 11). Other proposals which would access no fees in the absence of profits are by ABC, Inc. (ABC at 5), and the National Association of Broadcasters (Comments of the National Association of Broadcasters and the Association for Maximum Service Television, Inc., MM Docket No. 97-247 (filed May 4, 1998) at 11); *see also* Fox, *passim*.

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